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Date:
December 21, 2016

Taxpayer =
Date =
State =
County =
City =
Legislation =
Year =

Dear :

We are responding to a letter dated December 7, 2015, requesting rulings that Taxpayer's income is excludable from gross income under § 115 of the Internal Revenue Code (Code), and that contributions to Taxpayer are deductible by donors because Taxpayer is a government instrumentality under the terms of § 170. We construe the facts provided as follows.

FACTS

According to Taxpayer, a recent residential foreclosure crisis aggravated a period of long-term economic and demographic decline in State. Consequently, State enacted Legislation in Year to help a specific community address the consequences of this compounded crisis. The new law was extended to most State counties on Date, and it was designed to better equip the counties to address the crisis. In particular, it authorized the creation of a new type of organization to use various streamlined procedures and coordinate with government, non-profit, and commercial entities to stabilize communities and contribute to their economic development. Subsequently, State again amended State law to improve the procedures contained in the new law, and to afford organizations created under the law additional means of financial support, among other additions and revisions. Prior to Year, State and County engaged in

activities aimed at accomplishing community development similar to those addressed under the new law, but the procedures and tools available under prior State law were not as robust as those contained in the new law.

Pursuant to the new law, County established Taxpayer as its agent to facilitate the effective reclamation, revitalization, and return to economic productivity of abandoned or foreclosed real estate located in County. County can dissolve Taxpayer at any time, in accordance with State law.

Taxpayer's seven-member board of directors must include County's Fiscal Officer, County's Executive, and a member of County's Council. These three county directors confirm two additional directors. One of these directors is recommended by the mayor of City, and the other is recommended by the president of a county township association. The county directors select two additional directors, and by unanimous vote the county directors may remove any of the other directors. Taxpayer's directors do not receive compensation for their services to Taxpayer. A paid, professional staff manages Taxpayer's daily operations.

Taxpayer maintains a conflict of interest policy that supplements State's conflict of interest policy for public officials and employees. Among other things, Taxpayer's policy requires its officers, directors, and employees to sign a written form each year stating that they understand and agree to comply with Taxpayer's conflict of interest policy. State law requires Taxpayer to adhere to State's open meetings and public records requirements. Taxpayer must also provide an annual financial report to State, and the report must be available on Taxpayer's website. Taxpayer also makes available on its website other information such as agenda and minutes of board meetings, as well as descriptions of its programs.

Taxpayer's organizational documents provide that Taxpayer is intended to have the status of an organization whose income is excludable from gross income pursuant to § 115 of the Code, and that its authority and activities are limited accordingly. Further, the organizational documents require written annual statements from Taxpayer's officers and directors confirming that they understand Taxpayer exercises essential governmental functions, and that its income accrues to County. The organizational documents also provide for periodic reviews to ensure Taxpayer is performing essential governmental functions, and that its compensation arrangements are reasonable and the result of arm's length bargaining.

Taxpayer has adopted written policies and procedures governing the acquisition and disposition of residential and commercial properties. The policies and procedures are intended to provide consistency, transparency, standards, and safeguards to prevent abuse.

Taxpayer's funding is derived from several sources. The bulk of the Taxpayer's funding comes from County and State, with County committing a specified percentage of a delinquent tax and assessment collection fund. State has issued Taxpayer several grants to acquire and demolish abandoned residences. Taxpayer has also derived a limited amount of revenue from property sales. State law directs that Taxpayer must use revenue from its activities solely in furtherance of its statutory purposes.

Taxpayer coordinates with multiple county and other government offices to efficiently acquire and dispose of properties. Working with local governments, Taxpayer focuses on demolishing vacant and blighted residential structures in specified areas, and then on finding new owners for the properties so they can be returned to the tax rolls. Taxpayer may also acquire property for commercial or industrial redevelopment. Taxpayer advances its purposes at the local level by offering reimbursement and matching grants to local governments and certain nonprofit organizations to conduct activities that are consistent with Taxpayer's purposes.

Taxpayer's articles of incorporation provide that no part of its net earnings can inure to the benefit of or be distributable to any incorporator, director, trustee, or officer of Taxpayer, or to any private individual. Moreover, pursuant to the articles, upon dissolution, all remaining assets will be distributed to State, a political subdivision of State, or an entity whose income is excludable from gross income under § 115 of the Code.

LAW

Section 115(1) of the Code states that gross income does not include income derived from the exercise of any essential governmental function and accruing to a state or any political subdivision thereof.

Section 170(a)(1) provides that there shall be allowed as a deduction any charitable contribution (as defined in § 170(c)) payment of which is made within the taxable year.

Section 170(c)(1) states that, for purposes of § 170, the term charitable contribution means a contribution or gift to or for the use of a state, a possession of the United States, or any political subdivision of any of the foregoing, or the United States or the District of Columbia, but only if the contribution or gift is made for exclusively public purposes.

Revenue Ruling 77-261, 1977-2 C.B. 45, holds that income generated by an investment fund that is established by a state to hold revenues in excess of the amounts needed to meet current expenses is excludable from gross income under § 115(1), because such investment constitutes an essential governmental function and the income accrues to the state or its political subdivisions.

The ruling explains that the statutory exclusion is not intended to extend to the income of a state or municipality resulting from its own participation in activities, but rather to the income of an entity engaged in the operation of a public utility or the performance of some governmental function that accrues to either a state or political subdivision of a state. The ruling points out that that it may be assumed that Congress did not desire in any way to restrict a state's participation in enterprises that might be useful in carrying out projects that are desirable from the standpoint of a state government and that are within the ambit of a sovereign to conduct.

Revenue Ruling 90-74, 1990-36 I.R.B. 5, provides that the determination of whether a function is an essential government function depends on the facts and circumstances of each case. The ruling considers a risk-sharing pool created by local governments. Under state law, county governments could form and become members of a non-profit organization to pool their casualty risks. The governing body of each county authorizes it to join, and designate an individual to represent it at meetings and elect the board of directors. The counties pay initial deposits and annual fees based upon size and other determinants of risk. The organization also earns investment income. It reimburses members for casualty losses. If dissolved, it will distribute its assets to its members.

The revenue ruling states that political subdivisions insure against risks from casualties, employee negligence, worker's compensation, and employee health to satisfy government obligations. The private benefit to employees from the insurance is held to be incidental to the public benefit. The revenue ruling finds that pooling casualty risks through a separate organization instead of purchasing commercial insurance fulfills the obligations of the political subdivisions to protect their financial integrity. The revenue ruling further concludes that the income of the organization accrues to political subdivisions because (1) the organization's income does not benefit private interests; (2) the organization's income is used to reimburse counties for their losses and to reduce the annual fees that they would otherwise be required to pay the organization; and (3) the organization's assets were required to be distributed to the counties upon its dissolution.

Revenue Ruling 57-128, 1957-1 C.B. 311, provides that, in cases involving the status of an organization as a wholly owned instrumentality of one or more states or political subdivisions, the following factors are taken into consideration:

- (1) whether it is used for a governmental purpose and performs a governmental function;
- (2) whether performance of its function is on behalf of one or more states or political subdivisions;
- (3) whether there are any private interests involved, or whether the states or political subdivisions involved have the powers and interests of an owner;
- (4) whether control and supervision of the organization is vested in public authority or authorities;

- (5) if express or implied statutory or other authority is necessary for the creation and/or use of such an instrumentality and whether such authority exists; and
- (6) the degree of financial autonomy and the source of its operating expenses.

Revenue Ruling 75-359, 1975-2 C.B. 79, provides that a voluntary association of counties is separate from its member counties and qualifies as a wholly-owned instrumentality of those counties, which are political subdivisions, and is formed and operated exclusively for the public purposes of the member counties. Therefore, the revenue ruling holds that contributions to the association are deductible as contributions for the use of political subdivisions, subject to the limitation of § 170(b)(1)(B).

Revenue Ruling 69-453, 1969-2 C.B. 182, applies the six factors of Revenue Ruling 57-128 to rule that a soil and water conservation district formed as a private non-stock corporation by private individuals is not an instrumentality of the state. The revenue ruling finds the state has no authority or control over the district's expenditures, has no authority to remove any member of the district's board, and the district funds its operations through fees that it charges landowners for work done for the purpose of soil conservation. Moreover, the revenue ruling notes the state has no claim to the district's assets after the district's dissolution.

Revenue Ruling 65-196, 1965-2 C.B. 388, holds that a sports area commission formed pursuant to an agreement (which was authorized by the enactment of a state law legalizing such agreements) between a city and two villages to erect and operate an athletic stadium is an instrumentality of political subdivisions of the state. The commission is comprised of members appointed by councils of the city and villages as their representatives. Each member is required to be a citizen and resident of the state and may not be a member of the governing body of the city or the villages. The sole source of financing for the commission comes from bonds issued by the city; the city is authorized to issue bonds upon the request of the commission to fund the athletic stadium. The revenue ruling finds the commission is an instrumentality of the city and two villages by whose agreement it was formed because it meets substantially all of the Revenue Ruling 57-128 factors: the commission was created by the city and villages as their instrumentality, and validated by state law; the commission members are delegated certain authority under the terms of the agreement between the city and villages; control and supervision of the assets of the commission are in the hands of the city and villages; there are no private interests involved; and the city, upon the commission's direction, is responsible for the project's finances.

RULINGS REQUESTED

1. Because Taxpayer's income is derived from its performance of an essential governmental function and accrues to State, County, or other political subdivisions of State, or entities whose income is excludable from gross income

pursuant to § 115(1), Taxpayer's income is excludable from gross income pursuant to § 115(1).

2. Because Taxpayer is an instrumentality for purposes of § 170(c)(1), contributions to it are deductible to the extent otherwise allowed by § 170.

ANALYSIS

Issue 1.

In Year, State amended the law that it and County had used to target problems such as blighted, vacant, and foreclosed properties. The amendments streamlined procedures and gave counties new tools to tackle community ailments worsened by a burgeoning real estate crisis. County created Taxpayer in accordance with the new State law, and it designated Taxpayer to be its agent to carry out the statutory purposes of combating community deterioration by restoring abandoned and blighted property, and promoting economic and housing development in County. Transforming blighted, abandoned or foreclosed property into safe and economically productive property is an essential governmental function for purposes of § 115 of the Code.

County can dissolve Taxpayer at any time, and it controls Taxpayer's board of directors. County is Taxpayer's most consistent source of funding, although Taxpayer obtains substantial funding from State and, to a much lesser extent, from the sale of property Taxpayer acquires in furtherance of its purposes. Taxpayer operates according to State's open meetings and public records rules, is required to submit an annual financial report to State's official auditor, and it must display the report on its website. Taxpayer has taken many additional steps to ensure that private interests do not benefit from Taxpayer's activities more than incidentally. Taxpayer's articles ensure that upon dissolution its assets will be distributed to State, County, another political subdivision of State, or to an entity whose income is excludable from gross income under § 115. Therefore, taxpayer's income accrues to a state or political subdivision of a state.

Issue 2.

The second ruling requested raises the issue of whether Taxpayer is a separate, wholly-owned instrumentality of one or more political subdivisions of State, such that Taxpayer is eligible to receive charitable contributions within the meaning of § 170(c)(1). Section 170(c)(1) generally defines the term "charitable contribution," for purposes of § 170(a)(1), to include a contribution or gift to or for the use of a state or any political subdivision of the state, provided the contribution or gift is made for exclusively public purposes.

Taxpayer is not itself a political subdivision of State. Therefore, contributions to Taxpayer cannot constitute charitable contributions to a political subdivision of State for

purposes of § 170(c)(1). However, pursuant to Revenue Ruling 75-359, contributions to Taxpayer may constitute charitable contributions for the use of political subdivisions of State, which are deductible under § 170(a), subject to the limitation of § 170(b)(1)(B), if Taxpayer qualifies as a separate, wholly-owned instrumentality of one or more political subdivisions of State. A determination of whether Taxpayer is a wholly-owned instrumentality of one or more political subdivisions of State is made by applying the factors set forth in Revenue Ruling 57-128.

Governmental Purpose and Function

The first factor under Revenue Ruling 57-128 is whether Taxpayer is used for a governmental purpose and performs a governmental function. Taxpayer was established by County as its agent to facilitate the governmental purposes of reclamation, revitalization, and return to economic productivity of abandoned or foreclosed real estate located in County. Accordingly, we conclude Taxpayer is used for a governmental purpose and performs a governmental function.

Performance on Behalf of Political Subdivisions

The second factor under Revenue Ruling 57-128 is whether performance of Taxpayer's function is on behalf of one or more states or political subdivisions. Taxpayer was established pursuant to Legislation by County as its agent to exercise the governmental purposes referenced above. Prior to Taxpayer's formation, State and County engaged in activities aimed at community development similar to those presently performed by Taxpayer. A majority of Taxpayer's board of directors represent County and its political subdivisions. Further, Taxpayer's organizational documents require annual reports from its officers and directors stating they understand Taxpayer exercises essential governmental functions, and its income accrues to County. Based on these facts, we find that Taxpayer's function is performed on behalf of County, which is a political subdivision of State.

Private Interests Involved

The third factor under Revenue Ruling 57-128 is whether there are any private interests involved, or whether State or political subdivisions have the powers and interests of an owner. Taxpayer's revenue accrues to County. State law requires Taxpayer to adhere to State's open meetings and public records requirements. Taxpayer must also, pursuant to State law, provide an annual financial report to State and post it on its website. Furthermore, Taxpayer adopted a conflicts of interest policy that supplements State's conflict of interest policy for public officials and employees. Among other things, Taxpayer's policy requires its officers and directors, to file an annual form stating they understand and agree to comply with Taxpayer's conflicts of interest policy. Taxpayer's articles of incorporation provide that no part of its net earnings shall inure to the benefit of or be distributable to any incorporator, director, trustee, or officer of Taxpayer, or to

any private individual. Additionally, Taxpayer's organizational documents provide for periodic reviews to ensure Taxpayer is performing essential governmental functions and its compensation arrangements are reasonable and the result of arm's length bargaining. Taxpayer has also adopted written policies and procedures governing the acquisition and disposition of residential and commercial properties. Such policies and procedures are intended to provide consistency, transparency, standards, and safeguards to prevent abuse. Should Taxpayer dissolve, its articles of incorporation state that remaining assets will be distributed to State, a political subdivision of State, or an entity whose income is excludable from gross income under § 115. Therefore, based on the facts stated, we conclude there are not more than incidental private interests involved, and that political subdivisions of State have the powers and interests of an owner with respect to Taxpayer.

Control and Supervision

The fourth factor under Revenue Ruling 57-128 is whether control and supervision of Taxpayer is vested in public authority or authorities. Under the facts stated, Taxpayer's seven-member board of uncompensated directors must include County's Fiscal Officer, County's Executive, and a member of County's Council. These three County directors confirm two additional directors. One of these directors is recommended by the mayor of City, and the other is recommended by the president of a County township association. The county directors select two additional directors, and by unanimous vote the county directors may remove any of the other directors. Thus, the directors who represent County and political subdivisions within County must always be a majority of Taxpayer's board of directors. County can dissolve Taxpayer at any time, in accordance with State law. Therefore, based on the facts provided, we conclude the control and supervision of Taxpayer is vested in public authorities.

Statutory Authority

The fifth factor under Revenue Ruling 57-128 is whether express or implied statutory or other authority is necessary for the creation and use of Taxpayer and whether such authority exists. Pursuant to Legislation, County established Taxpayer as its agent to facilitate the effective reclamation, revitalization, and return to economic productivity of abandoned or foreclosed real estate located in County. The State legislature has extended and refined the authority in the years since, showing continuing approval. Taxpayer continues to function pursuant to specific State statutory authority. Consequently, we conclude that express statutory authority is necessary for the creation and use of Taxpayer and that such authority exists.

Financial Autonomy and Source of Operating Expenses

The sixth factor under Revenue Ruling 57-128 is the degree of Taxpayer's financial autonomy and the source of its operating expenses. Taxpayer is generally dependent

on County and State for financial support. The bulk of Taxpayer's funding comes from County and State, with County committing a specified percentage of a delinquent tax and assessment collection fund, and State providing several grants to acquire and demolish abandoned residences. Taxpayer also derives a limited amount of revenue from property sales. State law directs that Taxpayer must use revenue from its activities solely in furtherance of its statutory purposes. Based on these facts, we find that Taxpayer is not financially autonomous from State and its political subdivisions. Rather, Taxpayer relies heavily upon State and its political subdivisions for the funding of its operating expenses.

For the reasons stated above, Taxpayer is a wholly owned instrumentality of one or more political subdivisions of State. Similar to the taxpayer described in Revenue Ruling 65-196, and unlike the one in Revenue Ruling 69-453, Taxpayer is used for a governmental purpose and performs a governmental function; Taxpayer's function is on behalf of County, which is a political subdivision of State; there are not more than incidental private interests involved, and political subdivisions of State have the powers and interests of an owner, with respect to Taxpayer; control and supervision of Taxpayer is vested in public authorities; express statutory authority is necessary for the creation and use of Taxpayer and such authority exists; Taxpayer is not financially autonomous from State and its political subdivisions, but rather relies heavily upon State and its political subdivisions for the funding of its operating expenses. Therefore, in accordance with Revenue Ruling 75-359, we conclude that contributions to Taxpayer constitute charitable contributions (within the meaning of § 170(c)(1)) for the use of political subdivisions of State, that are deductible under § 170(a), subject to the limitation of § 170(b)(1)(B).

Conclusion

Consistent with the foregoing, we rule that:

1. Because Taxpayer's income is derived from its performance of an essential governmental function and accrues to State, County, other political subdivisions of State, and entities whose income is excludable from gross income pursuant to § 115(1), Taxpayer's income is excludable from gross income pursuant to § 115(1).
2. Because Taxpayer is an instrumentality for purposes of § 170(c)(1), contributions to it are deductible to the extent otherwise allowed by § 170.

These rulings are based on the facts as they were presented in the ruling request and on the understanding that there will be no material changes to those facts. These rulings do not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections expressly described herein.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter, or of any activity or transaction not expressly addressed in this letter.

The rulings contained in this letter are based upon information and representations submitted by Taxpayer and accompanied by a penalty of perjury statement executed by an individual with authority to bind Taxpayer, as specified in Revenue Procedure 2016-1, 2016-1 I.R.B. 1, §7.01(15)(b), or its successors. This office has not verified any of the material submitted in support of the request for rulings, and such material is subject to verification on examination.

The Associate Office will revoke or modify a letter ruling and apply the revocation retroactively if there has been a misstatement or omission of controlling facts; the facts at the time of the transaction are materially different from the controlling facts on which the ruling was based; or, in the case of a transaction involving a continuing action or series of actions, the controlling facts change during the course of the transaction. See Revenue Procedure 2016-1, § 11.05, or its successors.

This ruling letter is directed only to Taxpayer. Section 6110(k)(3) provides that it may not be used or cited as precedent.

This ruling letter will be made available for public inspection under § 6110 of the Code after certain deletions of identifying information are made. For details, see the enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling with deletions that we intend to make available for public inspection is attached to the enclosed Notice 437. If you disagree with our proposed deletions, you should follow the instructions in the enclosed Notice 437.

A copy of this ruling letter should be attached to Taxpayer's tax return for the current year. If the return is filed electronically, attach a statement containing the date and control number of the letter ruling.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

If you have any questions about this ruling, please contact the person whose name and phone number are shown in the heading of this letter.

Sincerely,

Kenneth M. Griffin
Chief
Exempt Organizations Branch 3
Tax Exempt and Government Entities